

Capital Formation in Indian Agriculture: A Review

N Chandrasekhara Rao*

This paper looks at the trends in investment behaviour in Indian agriculture with particular reference to the relationship between private capital formation and public capital formation. It also looks at inter-sectoral terms of trade, determinants and reasons for the decline of public capital formation, efficiency of capital use, and the demand for public capital formation in agriculture in the present Indian context. The declining trend of gross fixed capital formation in the eighties was reversed in the nineties mainly due to a good increase in private capital formation despite some decline in public capital formation. The complementarity between public and private capital formation in agriculture still holds good at the all-India level, as well as, in states, though there seems to have occurred some weakening of the inducement effect at the all-India level. Due to differences in composition, private capital cannot substitute public capital in agriculture. The impact of terms of trade on private capital formation increased over time. The efficiency of capital use declined during the nineties. There is higher demand for public capital formation in the present Indian context. The failure of the favourable terms of trade to improve agricultural production, productivity and thereby employment, the need for improving dry land agriculture and increased needs for research, extension and infrastructure development efforts in the liberalised trade regime; make non-price interventions with higher public investment an urgent need.

I Introduction

The economic reforms initiated in 1991 relied more on "getting the prices right" to bring dynamism to the agricultural sector. The overall liberalisation of the economy is expected to result in higher investment and growth in agriculture induced by favorable terms of trade, which is supposed to be the outcome of reduction of protection to industry and trade liberalisation. It was said that the gains in terms of increased investment in agriculture consequent to the liberalisation of non-agriculture would outweigh efficiency gains flowing from the liberalisation of agricultural trade and reduction of input subsidies. This is expected to lead to increase in rural employment (Bhalla, 1995; Parikh *et al.*, 1995; Rao, 1995,1998; Sen, 2001). However, by late nineties, the optimism with respect to reforms leading to higher investment, growth and employment has started to

* Associate Fellow, Centre for Economic and Social Studies, N. O. Campus, Begumpet, Hyderabad 500030. ncsrao@CESS.AC.IN

The author is grateful to Professor S. Mahendra Dev and Professor S. Galab for their valuable suggestions in preparation of this paper. The author is also thankful to Professor V. Ratna Reddy for encouragement. However, the usual disclaimer applies.